

ORIGINAL



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BEFORE THE ARIZONA CORPORATION COMMISSION

12

**COMMISSIONERS**

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2007 OCT 24 P 4:06

AZ CORP COMMISSION  
DOCKET CONTROL

IN THE MATTER OF THE APPLICATION OF ) DOCKET NO. G-04204A-06-0463  
UNS GAS, INC. FOR THE ESTABLISHMENT OF )  
JUST AND REASONABLE RATES AND )  
CHARGES DESIGNED TO REALIZE A )  
REASONABLE RATE OF RETURN ON THE )  
FAIR VALUE OF THE PROPERTIES OF UNS )  
GAS, INC. DEVOTED TO ITS OPERATIONS )  
THROUGHOUT THE STATE OF ARIZONA. )

IN THE MATTER OF THE APPLICATION OF ) DOCKET NO. G-04204A-06-0013  
UNS GAS, INC. TO REVIEW AND REVISE ITS )  
PURCHASED GAS ADJUSTOR. )

IN THE MATTER OF THE INQUIRY INTO THE ) DOCKET NO. G-04204A-05-0831  
PRUDENCE OF THE GAS PROCUREMENT )  
PRACTICES OF UNS GAS, INC. )

UNS GAS' EXCEPTIONS

Arizona Corporation Commission  
**DOCKETED**

OCT 24 2007

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1           UNS Gas, Inc. ("UNS Gas" or the "Company"), through undersigned counsel, hereby  
2 respectfully submits its exceptions to the Recommended Opinion and Order ("ROO") issued by  
3 the Presiding Administrative Law Judge in this case.

4           The ROO fails to provide UNS Gas with a reasonable opportunity to recover its costs of  
5 providing utility service and earn a reasonable return on its investment devoted to public service.  
6 While there was no finding that any UNS Gas cost or investment was imprudent, the ROO eroded  
7 the Company's rate request by, among other things:

- 8           (i)     failing to include Construction Work in Progress ("CWIP") in rate base;
- 9           (ii)    precluding the Company from recovering the cost of the Commission-required  
10           Global Information System ("GIS");
- 11           (iii)   establishing an artificially low return on equity;
- 12           (iv)    setting the monthly charge too low;
- 13           (v)     disallowing prudently incurred expenses; and
- 14           (v)     rejecting fair value as the basis for setting rates.<sup>1</sup>

15           If the Commission were to adopt the ROO in its current form, UNS Gas would realize an  
16 earned return on equity of approximately 7%. Moreover, UNS Gas' financial metrics would fall  
17 far below other similar gas utilities. For example, UNS Gas' Funds from Operations ("FFO")  
18 interest coverage and its FFO to debt ratio will be far below industry averages. Likewise, UNS  
19 Gas' net cash flow as a percentage of capital expenditures will be far below the industry average.  
20 In 2008, UNS Gas' net cash flow will be only about half of the required capital expenditures.  
21 Thus, UNS Gas will have to seek substantial amounts of new capital. If the ROO is adopted, new  
22 debt and equity capital will become ever more expensive because UNS Gas is riskier than other  
23 gas companies. In the long term, the combination of a substantial need for new capital and  
24

25 \_\_\_\_\_  
26 <sup>1</sup> The ROO also modified various other components of the Company's rate request. These  
27 adjustments are discussed in detail in UNS Gas' post-hearing briefs, which by this reference are  
incorporated herein. UNS Gas does not waive any of the positions or requests that it has presented  
in this case.

1 increased capital costs is a poor recipe for both ratepayers and shareholders. Urgent action is  
2 needed now to avoid these consequences and to put UNS Gas on firm financial footing.

3 If the ROO is not amended, the Company will have no option but to file another rate case  
4 as soon as possible to recover those prudently incurred costs and investments that, simply for  
5 timing reasons, are being ignored in this case. As UNS Gas' Chief Executive Officer, Mr. James  
6 S. Pignatelli stated:

7  
8 We do believe, though, that what we have requested here is the bare bones rate  
9 increase. It's what we need to continue to have a viable entity charged with  
10 providing safe and reliable service.

11 ...

12 We don't want to come in next year and the year after and the year after and start a  
13 never-ending parade of rate proceedings. That's why we must look beyond what  
14 technically maybe a historical test year is and get to the broader picture. What does  
15 it cost to serve the customer in the manner in which this Commission and this  
16 company desire to serve the customer?

17 I can tell you we have over \$85 million invested in equity in these properties. We  
18 have not taken a cent out of these properties. We continue to put additional money  
19 into these properties. We're incurring significant growth. We're up to almost  
20 150,000 customers now, and this customer growth continues at an annual rate of 5  
21 to 10 percent. We are serving gas in over half the state of Arizona, the sparsely  
22 populated half and the half that is growing rapidly.

23 ...

24 We have to work together to come to the right conclusion. I believe that we have  
25 done a fine job in maintaining a high level of service while our costs have  
26 skyrocketed. We held out rate relief for three years. Current rates reflect 2001, at  
27 best, costs. We need relief.<sup>2</sup>

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<sup>2</sup> Hearing Transcript ("Tr.") at 52-55.

1 No one can seriously argue that it would be in the public interest to subject the Company,  
2 its customers or the Commission to a series of rate cases that can reasonably be resolved in one  
3 proceeding. Nevertheless, that is the very process that the ROO will force the Company to follow.

4 UNS Gas respectfully requests that the Commission amend the ROO in accordance with  
5 these exceptions and issue a final order in this case that will allow the Company to timely recover  
6 its prudently incurred costs and provide it with an opportunity to earn a reasonable return on its  
7 prudent investment. UNS Gas needs adequate rate relief in order to continue to provide safe and  
8 reliable gas service to its current and future customers. In support hereof, UNS Gas states as  
9 follows:

10 **I. THE EVIDENCE IN THIS CASE SUPPORTS THE INCLUSION OF CWIP IN**  
11 **RATE BASE.**

12 UNS Gas has requested that \$ 7.2 million of CWIP be included in rate base in this case for  
13 ratemaking purposes. The ROO rejects the Company's request in its entirety and precludes CWIP  
14 from rate base. The requested CWIP must be in rate base in order for just and reasonable rates to  
15 be set for the Company at this time.

16 **A. The Commission should approve CWIP in this case.**

17 CWIP is an accepted regulatory tool that has been used by many states including Arizona  
18 for many years.<sup>3</sup> The ROO states that CWIP should be put in rate base only when there is an  
19 "extraordinary situation" and a "cash-flow crisis".<sup>4</sup>

20 The Arizona Supreme Court, on the other hand, has explicitly endorsed the use of CWIP,  
21 stating that "we wish to make it clear that construction work in progress ("CWIP") but not yet in  
22 service may be included in determining a fair value rate base."<sup>5</sup> The court said that it "is obvious  
23 that the Commission can consider matters subsequent to the historic year. Construction projects  
24

25 <sup>3</sup> Ex. UNSG-28 at 7.

26 <sup>4</sup> ROO at 6-7.

27 <sup>5</sup> *Arizona Community Action Assoc. v. Arizona Corp. Comm'n*, 123 Ariz. 228, 230, 599 P.2d 184,  
186 (1979)(quoting *Arizona Corp. Comm'n v. Arizona Public Service Co.*, 113 Ariz. 368, 371, 555  
P2d 326, 329 (1976).

1 contracted for and commenced during the historical year may certainly be considered by the  
2 Commission.”<sup>6</sup> CWIP is a means of allowing the utility and customers some time between rate  
3 cases. The court approved of that effect, commenting that “a constant series of extended rate  
4 hearings are not necessary to protect the public interest.”<sup>7</sup>

5 In fact, CWIP is an important tool for dealing with the impacts of growth. UNS Gas faces  
6 extraordinary growth. The new plant investment necessary to serve this growth depresses UNS  
7 Gas’ cash flow and other key financial measurements. Allowing CWIP will reduce those  
8 problems. In the long term, neither ratepayers nor shareholders benefit from a financially weak  
9 utility. Over the long term CWIP lowers the cost of debt and equity and reduces revenue  
10 requirement.<sup>8</sup> Moreover, the inclusion of CWIP in rate base produces significantly lower equity  
11 costs for a public utility and the savings in equity costs imply correspondingly lower ratepayer  
12 burdens.<sup>9</sup> The Commission should approve CWIP to help restore UNS Gas’ financial health, and  
13 to give customers and UNS Gas some breathing room between rate cases.

14 **B. UNS Gas faces extraordinary growth, which, without the inclusion of CWIP,**  
15 **will result in severe financial stress.**

16 It is undisputed that UNS Gas has faced, and will continue to face, high levels of growth.<sup>10</sup>  
17 For example, from 2003 to 2006, UNS Gas experienced a 35.4% increase in net plant investment,  
18 and the forecast for 2006 to 2009 is 36.9%.<sup>11</sup> On a per-customer basis, this investment level has  
19 increased by 19.1% over the period 2003 to 2006, and is forecasted to grow by 19.3% for 2006 to  
20 2009. By any measure, these are extraordinarily high rates of growth. UNS Gas’ growth rate is  
21  
22

23 <sup>6</sup> *Id.*

24 <sup>7</sup> *Id.*, 123 Ariz. at 230-31, 599 P2d. at 186-87.

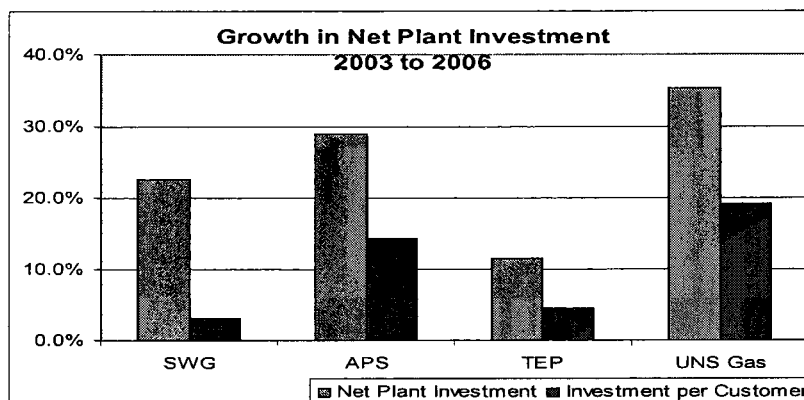
25 <sup>8</sup> See James C. Bonbright et al, *Principles of Public Utility Rates* (2<sup>nd</sup> ed. 1988) at 251 citing Roger  
26 A. Morin “An Empirical Study of the Effect of CWIP on Cost of Capital and Revenue  
Requirements” *Public Utilities Fortnightly* July 10, 1986 (Part I) and July 24, 1986 (Part II).

27 <sup>9</sup> Roger A. Morin, *New Regulatory Finance* (2006) at 367-69.

<sup>10</sup> Ex. UNSG-29 at Ex. KCG-15; Tr. at 920, 1004-5, 1020.

<sup>11</sup> *Id.*

much higher than other Arizona utilities. For example, a comparison in the growth of net plant investment for major Arizona utilities is shown in the graph below:



As may be seen from this graph, the recent growth in net plant investment on a per-customer basis is approximately six times higher than that experienced by another gas utility in Arizona, Southwest Gas Corporation ("Southwest Gas"). This extraordinary growth rate is due in large part to the low embedded cost of plant at UNS Gas, so rate base per customer is much higher for new customers than for existing customers.<sup>12</sup> For this reason, extra revenue from new customers is not sufficient to cover the capital costs required to serve them. Therefore, UNS Gas will likely be unable to earn its authorized rate of return in the foreseeable future.<sup>13</sup> Yet, UNS Gas faces very high capital expenditure requirements.<sup>14</sup> It is essential that UNS Gas maintain an ability to attract capital to meet these capital expenditure requirements. Even if the Commission grants all of UNS Gas' requests in this case, UNS Gas will need to attract tens of millions of dollars in new capital in the next few years.<sup>15</sup>

<sup>12</sup> Ex. UNSG-28 at 8; Tr. at 956.

<sup>13</sup> Ex. UNSG-28 at 8.

<sup>14</sup> Id.

<sup>15</sup> See, e.g., Ex. UNSG-27 at 27 (\$43 million in additional capitalization through 2009); Ex. UNSG-15 at 4 (noting more than \$61 million in capital spending from 2001 to 2005).

**C. If CWIP is not allowed, UNS Gas' financial integrity and ability to attract capital will be impaired.**

The rates proposed by the ROO are woefully inadequate. The ROO's proposed rates do not allow UNS Gas even a reasonable opportunity to earn the low ROE proposed in the ROO. Indeed, the ROO's proposed rates would result in an earned ROE of approximately 7% for the next several years.<sup>16</sup> This is far below the 10% ROE proposed by the ROO. Thus, even if 10% were a reasonable ROE, UNS Gas simply will not have a reasonable opportunity to earn that return.

Under the ROO's proposed rates, UNS Gas's financial metrics would fall far below those of other gas utilities. For example, UNS Gas' FFO interest coverage and its FFO to debt ratio will be far below industry averages.<sup>17</sup> Likewise, under Staff's proposed rates, UNS Gas' net cash flow as a percentage of capital expenditures would be far below the industry average.<sup>18</sup> For example, in 2008, UNS Gas' net cash flow would be only about half of the capital expenditures that will be required. Thus, UNS Gas will have to seek substantial amounts of new capital. If the ROO is adopted, new debt and equity capital would become ever more expensive because UNS Gas would be riskier than other gas companies and it has far weaker financial metrics. Increasing UNS Gas' cost of capital at a time when customer growth is creating such significant capital needs would not serve the long term interests of either ratepayers or shareholders.

Thus, adopting the rates proposed by the ROO would be poor public policy. Moreover, for the same reasons, adopting those rates will fall below the minimum standards established by the United States Constitution. The Constitution recognizes that "the investor has a legitimate

<sup>16</sup> Ex. UNSG-28 at Ex. KCG-14, page 1.

<sup>17</sup> UNSG-28 at Ex. KCG-14, page 4.

<sup>18</sup> UNSG-28 at Ex. KCG-14, page 2. Note that Professor Morin states that this metric is "a key quantitative determinant of credit quality." Roger A. Morin, *New Regulatory Finance* (2006) at 48.

1 concern with the financial integrity of the company whose rates are being regulated.”<sup>19</sup> The  
2 Constitution requires that rates, at a minimum, must:

3 ... [b]e enough revenue not only for operating expenses but also for the capital  
4 costs of the business. These include service on the debt and dividends on the  
5 stock.... By that standard the return to the equity owner should be commensurate  
6 with the returns on investments in other enterprises having corresponding risks.  
7 That return, moreover, should be sufficient to assure confidence in the financial  
8 integrity of the enterprise, so as to maintain its credit and to attract capital.”<sup>20</sup>

9 These standards are often called the “financial integrity” and “capital attraction” standards. The  
10 rates set by state utility commissions must meet these standards, and any failure to do so violates  
11 the takings clause of the United States Constitution.<sup>21</sup>

12 The rates proposed in the ROO fall well short of the “financial integrity” and “capital  
13 attraction” standards. For example, UNS Gas would earn substantially less than the 10% return on  
14 equity (which as discussed herein is an artificially low ROE for UNS Gas) proposed by the ROO.  
15 UNS Gas simply would have no opportunity to earn a return similar to that of comparable  
16 companies. As a small but fast growing utility, UNS Gas is much *more* risky, not *less* risky, than  
17 the average gas company. Under the ROO’s proposed rates, UNS Gas’ financial metrics would  
18 fall far below gas industry averages. Moreover, UNS Gas would have substantial difficulty  
19 attracting capital, yet it would still need massive amounts of capital to keep up with growth. For  
20 example, the Company needs an additional \$43 million in capitalization through 2009.<sup>22</sup> If this  
21 capital can be obtained at all, it would come be at very steep price, unless the Commission rejects  
22 the insufficient rates proposed by the ROO.

23 <sup>19</sup> *Federal Power Comm’n v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1943)

24 <sup>20</sup> *Id.* The *Hope* case also contained a separate holding that rates need not be set using fair value.  
25 While the United States Constitution does not require the use of fair value, the Arizona  
26 constitution does require fair value. See *Simms v. Round Valley Light & Power Co.*, 80 Ariz. 145,  
151, 294 P.2d 378, 382 (1956)(Commission cannot use *Hope* case to avoid fair value). *Simms* did  
27 not, and could not, authorize the Commission to set rates below the constitutional minimum  
standard established in *Hope*.

<sup>21</sup> *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 308-310 (1988).

<sup>22</sup> Ex. UNSG-27 at 27.

1           **D.     The ROO rejects CWIP using generic conclusions that are contradicted by the**  
2                       **evidence specific to UNS Gas.**

3           The ROO's rationale for rejecting the inclusion of CWIP in rate base does not rest on  
4 evidence relating to UNS Gas, but rather on generic considerations such as: (i) that growth is  
5 generally positive, (ii) that regulatory lag is sometimes positive, and (iii) that sometimes rate base  
6 issues can be avoided by selecting a different test year. These conclusions may be true in some  
7 situations unrelated to this case. However, the evidence in this case, specific to UNS Gas, shows  
8 that these generic conclusions do not apply to the Company. In evaluating evidence, "general  
9 conclusions may not be substituted for an evaluation of the evidence in each case."<sup>23</sup> Therefore,  
10 the Commission should reject the generic conclusions in the ROO and base its decision on the  
11 specific evidence relating to UNS Gas.

12           For example, the ROO cites testimony from RUCO that growth in some situations actually  
13 "has a positive aspect due to the increased of revenues associated with serving new customers."<sup>24</sup>  
14 The ROO also points to similar testimony by Staff that CWIP might cause a mismatch due to the  
15 revenues associated with new customers.<sup>25</sup> The facts show that for UNS Gas the extra revenue  
16 from new customers is much less than the costs of serving those customers. For example, in 2006,  
17 UNS Gas added \$17 million in net plant, resulting in an additional \$3 million in fixed costs  
18 (depreciation, interest, property taxes, etc).<sup>26</sup> But new customers added in 2006 provided only  
19 \$1.8 million in new revenues.<sup>27</sup> Therefore, UNS Gas incurred a revenue *deficiency* of \$1.2 million  
20 due to new growth in 2006.<sup>28</sup> Notably, Staff and RUCO did not dispute this example in their  
21 testimony. There can be no real argument, then, that for UNS Gas growth is not the financial  
22

23 *Butler Township Water Co. v. Pennsylvania Public Utility Comm'n*, 473 A.2d 219, 221-222 (Pa.  
24 Cmwlt. 1984).

24 ROO at 6:24-25.

25 ROO at 6:11-12.

26 Ex. UNSG-28 at 10.

27 *Id.*

28 *Id.*

positive that Staff and RUCO have hypothesized. The Commission's decision here should not be based on generic concerns that are contradicted by specific evidence relating to UNS Gas.

Along similar lines, the ROO speculates that "the regulatory lag inherent in utility regulation may provide benefits... and thereby help to mitigate periods of higher plant investment associated with customer growth."<sup>29</sup> While that may be true for some utilities, it is not the case for UNS Gas. As already described, the higher costs associated with new UNS Gas customers creates a severe drain on UNS Gas' financial integrity. Growth also negatively impacts cash flow, because new plant creates additional fixed costs, and because growth leads to capital requirements far in excess of the Company's internal cash flow.<sup>30</sup> As a result, the "impact of regulatory lag on UNS Gas is more pronounced than for most utilities."<sup>31</sup> As Moody's recently explained, a key factor in a utility's financial health is the "degree of regulatory lag" because high, recurring regulatory lag depresses cash flow and results in higher leverage and weaker credit metrics.<sup>32</sup> While regulatory lag may be positive for some companies, UNS Gas suffers much more from regulatory lag than most utilities – a fact that has real impacts on its financial health. The Commission's decision should be based on evidence regarding UNS Gas, not speculation about other utilities.

The ROO further notes that CWIP was used back in the 1980s for Arizona Public Service ("APS") to address the impacts of building Palo Verde. The ROO implies that UNS Gas is in a much better position than APS was at that time. However, UNS Gas does share the same problem that APS was facing, namely a large construction program and weak operating cash flows.

Finally, the ROO criticizes UNS Gas for even raising these issues, stating that "[a]s we have stated in prior cases, regulated utility companies control the timing of their rate case filings and should not be heard to complain when their chosen test periods do not coincide with the

<sup>29</sup> ROO at 7:3-5.

<sup>30</sup> Ex. UNSG-28 at 9.

<sup>31</sup> Ex. UNSG-27 at 28.

<sup>32</sup> Ex. UNSG-28 at 12-13.

1 completion of plant that may be considered used and useful and therefore properly included in rate  
2 base.”<sup>33</sup> The ROO misses an important point. UNS Gas was precluded by the Commission for  
3 three years from filing a rate case. UNS Gas was severely limited by the Commission as to when  
4 it could file for rate relief and what test year it could use to seek such relief. If the Company had  
5 not been precluded by the Commission from seeking rate relief sooner, the timing of the request  
6 for relief sought in this case and many of the issues certainly would have been different. But the  
7 Company must deal with reality and not generic observations. The Commission’s decision should  
8 be based on the evidence in this case, not conclusions or evidence from other cases about other  
9 companies. Moreover, under the ROO’s logic, CWIP would never be available to any company –  
10 despite the fact that it is allowable and has been used in the past. In some cases, utilities may be  
11 able to avoid problems by selecting better test years. For example, if a utility is nearing  
12 completion of a large plant, in some circumstances it may wait until that plant is in service before  
13 filing the rate case. But the CWIP incurred by UNS Gas does not typically result from a single  
14 large project. Rather it incorporates a multitude of small, recurring projects. Thus, on any  
15 particular date, UNS Gas will always have substantial amounts of CWIP. For example, UNS Gas’  
16 year-end CWIP balances were as follows (from Schedule E-1):

Year	CWIP at year end
2003	\$ 9,916,507
2004	\$10,786,699
2005	\$ 7,189,231

21 Hence, for UNS Gas, CWIP is not a problem that can be avoided by simply selecting a different  
22 test year.

23 This rationale could create inappropriate incentives – potentially endorsing the view that  
24 utilities should base plant decisions on regulatory strategies, rather than on customer needs and  
25 sound engineering practices. In some situations, this approach would encourage utilities to build  
26

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27 <sup>33</sup> ROO at 9:24-27.

1 plant before it is needed, just so it meets the end of the test year. In other situations, it would  
2 encourage utilities to delay needed projects until a test year is near to minimize the time between  
3 when the project is finished and when it is included in rates. The Commission should soundly  
4 reject this approach.

5 For all the foregoing reasons, the Commission should amend the ROO and include \$7.2  
6 million of CWIP in rate base.

7 **II. ALTERNATIVELY, THE EVIDENCE IN THIS CASE SUPPORTS THE**  
8 **INCLUSION OF POST TEST YEAR PLANT IN RATE BASE.**

9 UNS Gas has requested that, alternatively, \$6.8 million of Post Test Year Plant be included  
10 in rate base. The ROO rejects the Company's request in its entirety and precludes post test year  
11 rate base from rate base. For the same reasons as set forth for CWIP, post test year plant should  
12 be in rate base in order for just and reasonable rates to be set for the Company at this time.

13 If the Commission does not allow CWIP into rate base, then it should include post test year  
14 plant in rate base. The Commission approved post test year plant in a number of recent cases.<sup>34</sup>  
15 UNS Gas faces faster growth than other utilities in Arizona.<sup>35</sup> Given the large number of other  
16 cases approving post test year plant, it is certainly justified in this case. The only factor the ROO  
17 mentions against using post test year plant is the possibility of a mismatch due to extra revenues  
18 relating to the new plant.<sup>36</sup> However, as already shown, revenues from new customers do not  
19 come close to covering the fixed costs related to those new customers.. Thus, unless some  
20 adjustment is made, UNS Gas will continue to realize a sizeable revenue deficiency on the post  
21 test year assets. The record in this docket shows that \$5.1 million of the \$7.2 million in CWIP was  
22  
23

24 <sup>34</sup> See e.g., *Arizona-American Water Co. (Paradise Valley)*, Decision No. 68858 (July 28, 2006);  
25 *Chaparral City Water Co.*, Decision No. 68176 (September 30, 2005); *Rio Rico Utilities, Inc.*,  
26 Decision No. 67279 (October 5, 2004); *Arizona-American Water Co.*, Decision No. 67093 (June  
30, 2004); *Arizona Water Co.*, Decision No. 66849 (March 19, 2004); *Bella Vista Water Co., Inc.*, Decision No. 65350 (November 1, 2002).

27 <sup>35</sup> Ex. UNSG-29 at Ex. KCG-15; Tr. at 920, 1004-5, 1020.

<sup>36</sup> ROO at 8.

1 in service within five months of the end of the test year and \$6.8 million was in service within  
2 twelve months after the test year.<sup>37</sup>

3 Accordingly, the Commission should amend the ROO to include \$6.8 million of post test  
4 year plant in rate base.

5 **III. IF THE COMMISSION FAILS TO ALLOW CWIP IN RATE BASE, IT SHOULD**  
6 **NOT FURTHER PENALIZE UNS GAS BY DEDUCTING CWIP-RELATED**  
7 **ADVANCES.**

8 If CWIP or Post Test Year Plant is not included in rate base, then the Company should not  
9 be penalized further by the deduction from rate base of \$4 million in customer advances related to  
10 the CWIP. The Commission should not further harm the Company's financial integrity by  
11 allowing the deduction.

12 Allowing CWIP or post-test year plant into rate base would be the best solution to  
13 addressing the financial problems UNS Gas faces due to growth. But if these alternatives are not  
14 chosen, then at the very least, the Commission should not further penalize UNS Gas by deducting  
15 from rate base advances related to CWIP. Doing so hurts the Company twice – not only are  
16 needed CWIP amounts not added to rate base, but rate base is actually reduced by something that  
17 had not been in rate base.

18 Generally, advances are deducted from rate base because customer-supplied advances are a  
19 “cost-free” source of capital for the utility. For example, if UNS Gas uses a \$10,000 advance to  
20 construct plant that is in service, the net effect is zero, as follows:

21 Plant in service:	+ \$10,000
22 Offset for advances:	<u>- \$10,000</u>
23 Net impact on rate base:	\$0

24  
25  
26  
27  

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<sup>37</sup> See Attachment 1 to this Brief.

In this example, deducting advances from rate base works as intended, resulting in no change to rate base. However, when the advance will be used to pay for plant that is not yet in rate base, the calculation breaks down – which is the case here:

Plant in service:	+	\$0
Offset for advances:	-	<u>\$10,000</u>
Net impact on rate base:	-	\$10,000

In this situation, the utility's existing rate base, which was financed with investor-supplied capital is arbitrarily reduced by \$10,000. Of course, if the problem were limited to \$10,000 it would be of only theoretical interest. UNS Gas, though, has \$4 million in advances related to CWIP.<sup>38</sup> The effect of excluding these customer advances from rate base is to wipe \$4 million of existing capital off the books for purposes of setting rates. Such a confiscation of capital is unfair.

The ROO speculates that had UNS Gas not requested CWIP “there would presumably not have been an issue with respect to... deducting advances from rate base.”<sup>39</sup> The word “presumably” infers that this statement is not supported by any evidence. That statement is wrong. Even if UNS Gas never proposed CWIP, it is unreasonable to assume that UNS Gas would allocate \$4 million of CWIP-related customer advances to plant in service that has already be financed with investor-supplied capital.

For most utilities, the recommended treatment of customer advances is a minor inconvenience. But for UNS Gas it is a serious problem. The Commission recently recognized that when the amounts have a real impact on the company, this effect is not fair. In that case, Arizona-American Water Company asked for a hook-up fee increase to pay for a water treatment plant. Hook-up fees are treated as contributions, and for water companies, contributions are deducted from rate base like advances. Because the plant will take some time to build, Arizona-American will collect a lot of contributions before the plant is operational. That would cause rate base to “decline rapidly as hook-up fees are collected, only to bounce back as plant enters

<sup>38</sup> Ex. UNSG-29 at 9.

<sup>39</sup> ROO at 9.

1 service.”<sup>40</sup> The Commission recognized such a result would harm both customers and the utility,  
2 and it therefore ordered the additional contributions to not be deducted from rate base.<sup>41</sup>

3 The same reasoning applies here. Deducting the advances would reduce UNS Gas’ rate  
4 base by \$4 million. In the next rate case, though, the Company’s rate base will increase by \$7  
5 million (the amount of CWIP, which by that time will all be in service). Such a “bounce back”  
6 effect makes no sense and harms the Company.

7 The Commission should amend the ROO by not deducting the \$4 million in CWIP related  
8 advances from rate base, if it does not allow CWIP in rate base.

9 **IV. THE COMMISSION SHOULD RECOGNIZE THE GEOGRAPHIC**  
10 **INFORMATION SYSTEM (GIS) IN RATE BASE.**

11 UNS Gas requests that \$897,098 be included in rate base to reflect the cost of its GIS. The  
12 ROO proposes to reject the rate base adjustment because the Company did not previously request  
13 an accounting order. However, the Commission should include the GIS costs in rate base because  
14 the GIS system was required by the Commission and is providing substantial cost-effective  
15 benefits to the Company.

16 Staff directed that the GIS project be undertaken and thus requiring the Company to incur  
17 these costs.<sup>42</sup> The Commission “must consider” the costs of complying with the Commission’s  
18 requirements. *Arizona Corp. Comm’n v. Palm Springs Utility Co., Inc.*, 24 Ariz. App. 124, 130,  
19 536 P.2d 245, 251 (1975). Because the GIS costs were incurred at the request of the  
20 Commission’s representatives, the Commission should allow recovery of these costs.

21 UNS Gas’ GIS is a prime example of increasing productivity through increased use of  
22 information technology.<sup>43</sup> It was undisputed that the GIS creates many benefits, including:  
23  
24

25 <sup>40</sup> *Arizona –American Water Co.*, Decision No. 69914 (September 27, 2007) at 7.

26 <sup>41</sup> *Id.* at 29.

27 <sup>42</sup> *Id.*

<sup>43</sup> *Id.* at 6.

- 1 (i) Faster emergency response due to the ability to quickly locate system controls (such
- 2 as valves);
- 3 (ii) Better informed planning through computer modeling of the gas system;
- 4 (iii) Faster work processes, including quicker mapping of the system, which is
- 5 especially important in a fast-growing system; and
- 6 (iv) Increased accuracy and safety because field employees can access up-to-date maps
- 7 on their portable computers.<sup>44</sup>

8 The GIS therefore provides clear benefits in safety and productivity that benefit customers.

9 UNS Gas therefore requests that it be allowed to recover the GIS costs as a regulatory asset.

10 The ROO proposes that these costs be denied because UNS Gas failed to request an  
11 accounting order.<sup>45</sup> RUCO and Staff have not said they would have opposed an accounting order  
12 if one had been requested earlier, and they have not questioned the amount of GIS costs or the  
13 substantial benefits of the GIS system. An accounting order is not necessary to include a used and  
14 useful asset – implemented at the direction of the Commission – in rate base. Rate cases should  
15 reflect the economic reality of the costs incurred at the direction of the Commission rather than  
16 regulatory technicalities.

17 The Commission should amend the ROO to include \$897,098 in rate base to reflect the  
18 cost of the GIS that the Commission directed UNS Gas to undertake.

19 **V. THE COMMISSION SHOULD GRANT A REASONABLE RETURN ON EQUITY.**

20 UNS Gas requests a return on equity (“ROE”) of 11.0%, which reflects the specific  
21 circumstances of UNS Gas and its commensurate level of risk. The ROO rejected the Company’s  
22 request and proposes adopting Staff’s recommended ROE of 10.0%, which is 75 basis points less  
23 than was recently granted to APS, a larger and less riskier company. The Commission should  
24 grant UNS Gas an ROE of 11.0% to reflect the specific circumstances of UNS Gas.

25  
26  
27 <sup>44</sup> Id. at 6-7.

<sup>45</sup> ROO at 10-11.

1 The ROO adopts Staff's ROE recommendation, which was made by Mr. Parcell. Mr.  
2 Parcell is no stranger to the Commission – he has been involved in many recent cases. One of  
3 those cases was the recent APS rate case. In the APS case, Mr. Parcell used the same methods he  
4 used in this case.<sup>46</sup> In the APS case, the Commission did not follow Mr. Parcell's  
5 recommendation.<sup>47</sup> But the ROO in this case adopts Mr. Parcell's recommendation without  
6 change. Since Mr. Parcell's methods have not changed, the Commission's ruling should similarly  
7 reject his recommendation in this case. In the APS case, the Commission adopted an ROE 50  
8 basis points higher than Mr. Parcell recommended, resulting in an ROE of 10.75%. Applying the  
9 same 50 basis point adder here would result in an ROE of at least 10.5%.

10 There are obvious differences between APS and UNS Gas that further justify an 11% ROE  
11 for the Company. UNS Gas is much smaller, is not paying a dividend, and is growing much faster  
12 in terms of net plant investment. Those factors suggest that UNS Gas is more risky than APS, and  
13 should therefore have a higher ROE. Thus, UNS Gas' proposed ROE of 11% is fully supported in  
14 the record through the Company's testimony. But at the very least, UNS Gas should be allowed an  
15 ROE consistent with the APS case.

16 In order to reflect the evidence in this case and be consistent in its approach with regards to  
17 ROE, the Commission should amend the ROO and grant UNS Gas an ROE of 11.0%.

18 **VI. THE COMMISSION SHOULD INCREASE UNS GAS' MONTHLY CHARGE TO**  
19 **REDUCE THE SIGNIFICANT EXISTING CROSS SUBSIDY BETWEEN COLD**  
20 **WEATHER AND WARM WEATHER CUSTOMERS.**

21 UNS Gas proposes increasing its monthly charge to residential customers from \$7.00 per  
22 month to \$17.00 per month and decreasing its base volumetric charge to ameliorate substantial  
23 cross-subsidization of warm weather customers by cold weather customers. The ROO rejects the  
24 Company's proposal and adopts Staff's proposed monthly charge of \$8.50, which would leave in  
25

26 <sup>46</sup> Compare ROO at 43-45 to *Arizona Public Service Co.*, Decision No. 69663 (June 28, 2007) at  
27 46-49.

<sup>47</sup> *Arizona Public Service Co.*, Decision No. 69663 (June 28, 2007) at 49.

1 place inequitable cross subsidies. Continuing these cross subsidies is not in the public interest.  
2 And the monthly charges should more closely reflect the fixed monthly costs caused by each  
3 customer.

4 Currently, UNS Gas' cold weather customers are paying a substantial subsidy to its warm  
5 weather customers. For example, under current rates, a residential customer in Flagstaff pays  
6 almost twice as much for the Company's fixed costs as a residential customer in Lake Havasu  
7 City.<sup>48</sup> In fairness, this subsidy should be reduced. Therefore, UNS Gas proposes increasing the  
8 monthly charge from \$7 to \$17 a month. An offsetting reduction to the volumetric price of gas  
9 means that an average customer's overall bill would increase only a few percent.<sup>49</sup> This rate  
10 design will reduce the large subsidy cold weather customers pay for the benefit of warm weather  
11 customers. A higher monthly charge will reduce that cross-subsidy.

12 This new rate design also would also create a better match between fixed revenues and  
13 fixed costs. Presently, UNS Gas incurs \$26 per month in fixed costs to serve a customer. The  
14 monthly customer charge, though, is just \$7. The current rate design only collects approximately  
15 25% of fixed distribution costs through the monthly customer charge.<sup>50</sup> The ROO proposes a  
16 small increase to \$8.50. Under that increase, only 30% of fixed distribution costs will be  
17 recovered through the monthly customer charge.<sup>51</sup> While the ROO trumpets this as a "significant  
18 movement towards cost-based rates," the modest change of 5% would still leave 70% of fixed  
19 costs to be recovered through variable volumetric charges.

20 While UNS Gas appreciates the goal of "gradualism", cold weather customers should not  
21 be required to pay a large subsidy for an undue period of time. Cold weather customers have the  
22 largest bills, and are thus least able to afford such a subsidy. Ironically, the ROO's monthly charge  
23 is still less than the monthly charge of \$9.70 approved in the last Southwest Gas rate case.<sup>52</sup>

24 \_\_\_\_\_  
25 <sup>48</sup> Ex. UNSG-18 at 8 and Ex. TLV-1 thereto.

26 <sup>49</sup> See UNS Gas Final Schedules, Schedule H-4.

27 <sup>50</sup> Tr. at 445.

<sup>51</sup> See Tr. at 445.

<sup>52</sup> *Southwest Gas Corp.*, Decision No. 68487 (February 23, 2006) at 38.

1 Southwest Gas does not have the cold weather Northern Arizona service that UNS Gas does.  
2 Therefore, it likely has much less of a cross-subsidy problem. Thus, UNS Gas should have a  
3 higher monthly charge than Southwest Gas – but at the very least it should not be lower than  
4 Southwest Gas.

5 The Commission should amend the ROO and approve a monthly charge of \$17 to reduce  
6 existing significant cross subsidies and to more closely match the monthly charge to actual fixed  
7 costs per customer.

8 **VII. THE COMMISSION SHOULD ALLOW UNS GAS TO RECOVER ALL**  
9 **PRUDENTLY INCURRED EXPENSES.**

10 UNS Gas has requested recovery of several categories of expenses. The Company has  
11 prudently incurred the expenses requested in this rate case, has provided proof of those expenses,  
12 and is, therefore, entitled to recovery of those expenses. However, the ROO has reduced recovery  
13 of certain expenses even though there is no evidence in the record that expenses were imprudent or  
14 not incurred. In particular, the ROO has reduced rate case expenses, certain employee  
15 compensation expenses and a category of small expenses. The Commission is obligated to allow  
16 recovery of prudently incurred expenses.

17 **A. Utility commissions are required to provide recovery of operating expenses.**

18 Under the United States Constitution, utility commissions are required to provide recovery  
19 of both operating expenses and capital costs.<sup>53</sup> And under the Arizona Constitution, the  
20 Commission is further required “to allow a recovery for all reasonable expenses.”<sup>54</sup> In other  
21 words, the Commission must provide sufficient income to permit full recovery of “operating  
22 costs” in addition to the return on rate base.<sup>55</sup> In addition, the Commission “must consider” any  
23 “expenditures made in compliance with the Commission’s decision[s].”<sup>56</sup>

24  
25 <sup>53</sup> See *Federal Power Comm’n v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1943).

26 <sup>54</sup> *Tucson Electric Power Co. v. Arizona Corp. Comm’n*, 132 Ariz. 240, 245, 645 P.2d 231, 236 (1982).

27 <sup>55</sup> *Scates v. Arizona Corp. Comm’n*, 118 Ariz. 531, 533-34, 578 P.2d 612, 614-15 (App. 1978).

<sup>56</sup> *Arizona Corp. Comm’n v. Palm Springs Utility Co.*, 24 Ariz. App. 124, 536 P.2d 245 (1975).

1 In evaluating costs under this framework, the utility's expenses are presumed to be  
2 reasonable and incurred in good faith.<sup>57</sup> While the utility bears the initial burden of proof, once  
3 the utility makes a "prima facie case for the reasonableness of its operating expenses... [t]he  
4 burden then shifts to the [adverse party] to show by substantial, competent evidence that the  
5 expenditures were unreasonable by reason of inefficiency or bad faith."<sup>58</sup>

6 **B. UNS Gas is entitled to its requested Rate Case Expense.**

7 UNS Gas requested \$900,000 in rate case expenses. Without considering the Company's  
8 actual rate case expenses, the ROO proposes reducing the rate case expenses to the amount  
9 allowed Southwest Gas in its most recent rate case. However, unlike UNS Gas, Southwest Gas  
10 conducts its rate case almost entirely with in-house personnel who are on salary. Moreover, UNS  
11 Gas' requested rate case expenses were prudently incurred and reflect the cost of its first rate case,  
12 including over twice the discovery from Staff and intervenors than was conducted in the  
13 Southwest Gas case.

14 **1. The comparison with Southwest Gas is invalid.**

15 The ROO allows UNS Gas to recover only one-third of its requested rate case expense.  
16 The ROO bases this decision on a comparison to the rate case expense allowed in the recent  
17 Southwest Gas rate case, stating that "Southwest Gas is an appropriate measure of comparison for  
18 UNS Gas."<sup>59</sup> This conclusion is flawed for several reasons. Most fundamentally, rate case  
19 expense cannot be judged by comparisons to other utilities. This is because rate case expense is  
20 "highly specific to the particular utility and the particular rate case in question" and therefore rate  
21 case expense in one case legally has "no bearing" on what should be allowed in another case.<sup>60</sup>

22 Moreover, even if it was valid to compare rate case expenses of different utilities, the  
23 evidence shows that Southwest Gas differs from UNS Gas in key ways that make their expenses

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25 <sup>57</sup> *West Ohio Gas Co. Public Utility Comm'n of Ohio*, 294 U.S. 63, 72 (1935).

26 <sup>58</sup> *Boise Water Corp. v. Idaho Public Utilities Comm'n*, 555 P.2d 163, 169 (Idaho 1976).

27 <sup>59</sup> ROO at 22:9.

<sup>60</sup> *City of Lancaster (Sewer Fund) v. Pennsylvania Public Utility Comm'n*, 793 A.2d 978, 982-984.  
(Pa. Cmwlth. 2002).

1 not directly comparable. Southwest Gas has an entire department of rate experts, as well as in-  
2 house lawyers, to manage its rate cases. The cost of those resources is included in Southwest Gas'  
3 overall overhead and administrative expenses, and therefore is excluded from rate case expense.  
4 In contrast, UNS Gas does not have those resources and must rely on outside services from TEP  
5 and other vendors. Therefore, it is no surprise that UNS Gas' rate case expense is much higher.  
6 Moreover, if UNS Gas followed Southwest Gas' methodology, several other expenses would be  
7 higher. The evidence is clear:

- 8 • Southwest Gas' internal personnel and support services are built into its base rates;  
9 in contrast, UNS Gas does not have those costs built in and must recover them  
10 through the rate case expense.<sup>61</sup>
- 11 • Southwest Gas' overhead costs for rate cases, including in-house experts, lawyers,  
12 and support and administrative personnel, are allocated using the Massachusetts  
13 formula to the three states it serves. UNS Gas does not have the same structure.  
14 When TEP employees perform UNS Gas activities, those activities must be directly  
15 recorded so that only those costs are charged to UNS Gas.<sup>62</sup>
- 16 • If UNS Gas used the Southwest Gas Massachusetts Formula, its test-year expenses  
17 would be \$2.5 million higher.<sup>63</sup>
- 18 • UNS Gas received 605 data requests from Staff and intervenors, including 440 of  
19 those with subparts. Southwest Gas received only 285 data requests, including only  
20 206 with subparts.<sup>64</sup>

21 Staff and RUCO do not dispute the evidence concerning those differences. So there should be no  
22 dispute that any comparison of rate case expense between Southwest Gas and UNS Gas is deeply  
23 flawed. Although these differences were not contested at the hearing, the ROO does not consider  
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25 <sup>61</sup> Ex. UNSG-13 at 33-35.

26 <sup>62</sup> Ex. UNSG-13 at 33-35; Ex. UNSG-14 at 9-11; Tr. at 281, 887-88.

27 <sup>63</sup> Ex. UNSG-14 at 10.

<sup>64</sup> Ex. UNSG-13 at 34-35.

1 them. Instead, the ROO cites RUCO's testimony that both companies "extensively used in-house  
2 staff" for rate cases and are therefore comparable.<sup>65</sup> Under cross-examination, though, RUCO's  
3 witness, Mr. Moore, testified that UNS Gas does not have in-house staff for most rate case  
4 functions.<sup>66</sup> It was TEP's staff that performed the rate case work. Thus, any comparison between  
5 UNS Gas and Southwest Gas is wholly discredited. Moreover, the courts have recognized that  
6 whether a utility has in-house staff is a specific, legitimate reason for rate case costs to differ  
7 between utilities.<sup>67</sup>

8 **2. *The Commission should reject Staff's vague, last-second "concerns".***

9 Perhaps recognizing the weakness of the comparison to Southwest Gas, the ROO points to  
10 the testimony of Staff's hired lawyer/expert, Mr. Ralph Smith.<sup>68</sup> Mr. Smith did not propose an  
11 adjustment to the Company's rate case expense in his Direct Testimony. In Surrebuttal Testimony,  
12 however, he adopted RUCO's adjustment which was based on the comparison to Southwest Gas.<sup>69</sup>  
13 On the stand, Mr. Smith was unable to support this adjustment, testifying that he was not familiar  
14 with Southwest Gas' accounting.<sup>70</sup> Recognizing that his comparison to Southwest Gas was  
15 therefore discredited, on re-direct and re-cross, Mr. Smith attempted to articulate a new  
16 justification for the disallowance.<sup>71</sup> Although the exact basis of Mr. Smith's on-the-fly  
17 justification is unclear, it has something to do with a vague concern over UniSource Energy's  
18 overall allocation methods. Notably, this "concern" was not limited to rate case expense, yet Staff  
19 proposed no other adjustment based on this supposed concern.

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21  
22 <sup>65</sup> ROO at 21:12-14.

23 <sup>66</sup> Tr. at 623, 629-30.

24 <sup>67</sup> *City of Lancaster (Sewer Fund) v. Pennsylvania Public Utility Comm'n*, 793 A.2d 978, 982-984.  
(Pa. Cmwlth. 2002).

25 <sup>68</sup> ROO at 21-22. The testimony cited by the ROO was on re-cross, not cross-examination as  
stated in the ROO.

26 <sup>69</sup> Ex. S-27 at 42-44.

27 <sup>70</sup> Tr. at 886-894.

<sup>71</sup> Tr. at 895-898.

1           Whatever Mr. Smith's new concern, it should not be considered because it was not  
2 included in pre-filed testimony. Staff, like the other parties, was ordered to pre-file its testimony.  
3 The Commission recently rejected a similar attempt by Staff to introduce a new argument at  
4 hearing, explaining "the timing of Staff's changed recommendation is problematic because it did  
5 not afford other parties an opportunity to explore fully the underlying basis of Staff's proposal."<sup>72</sup>  
6 The same is true here. Indeed, this example is even more problematic because Staff waited until  
7 re-direct and re-cross to introduce its new argument. As such, other parties were not afforded a  
8 fair opportunity to explore this new argument.

9                           **3.       *The Commission must approve prudent rate case expenses.***

10           Rate case expense is included under the general principle that utility commissions must  
11 allow recovery in rates of all prudently incurred expenses.<sup>73</sup> Therefore, the Commission is  
12 required to allow recovery of prudently incurred rate case expense.<sup>74</sup> Disturbingly, Mr. Smith  
13 refused to state that the Commission should allow recovery of prudent rate case costs.<sup>75</sup> No party  
14 has disputed the amount of rate case costs incurred by UNS Gas. Nor has any party argued that  
15 UNS Gas' overall conduct of the case, or any specific arguments or actions, was unreasonable. A  
16 reduction or disallowance in rate case expense can be justified when the rate case is "abortive or  
17 frivolous"<sup>76</sup> A reduction also can be justified by a showing that "any particular expenditure...  
18 [was] unreasonably or excessively incurred."<sup>77</sup> No party has attempted to show that UNS Gas'  
19 rate case expense is imprudent using one of these methods. Thus, UNS Gas' rate case expense is  
20 prudent and should be recovered in rates.

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23 <sup>72</sup> *Arizona-American Water Co. (Mohave)*, Decision No. 69440 (May 1, 2007) at 15.

24 <sup>73</sup> *Butler Township Water Co. v. Pennsylvania Public Utility Comm'n*, 473 A.2d 219, 221-22 (Pa.  
Cmwlth. 1984).

25 <sup>74</sup> *Id.*

26 <sup>75</sup> Tr. at 897-898.

27 <sup>76</sup> *Maine Water Co. v. Public Utilities Comm'n*, 482 A.2d 443, 453 (Me. 1984).

<sup>77</sup> *City of Lancaster (Sewer Fund) v. Pennsylvania Public Utility Comm'n*, 793 A.2d 978, 982-984.  
(Pa. Cmwlth. 2002).

1 The Commission should amend the ROO and approve the Company's full request for  
2 \$900,000 in Rate Case Expenses.

3 **C. UNS Gas is entitled to its requested Employee Compensation Expenses.**

4 UNS Gas requested to recover \$137,262 in expenses for three incentive compensation  
5 programs: the Performance Enhancement Program, the Supplemental Executive Retirement Plan  
6 and the Officer's Long-Term Incentive Program. No party argued that UNS Gas' overall level of  
7 employee compensation expenses was imprudent. Indeed, UNS Gas' average cash compensation  
8 is below that of comparable firms.<sup>78</sup> That should be the end of the matter, and as there is no issue  
9 of prudence, UNS Gas' employee compensation expenses should be recovered in rates. Although  
10 the ROO does not claim that overall employee compensation costs are imprudent, it nevertheless  
11 disallows parts of three specific components of those costs.

12 **1. Performance Enhancement Program ("PEP").**

13 First, the ROO disallows 50% of UNS Gas' Performance Enhancement Program ("PEP")  
14 costs. The ROO euphemistically calls this "sharing" between ratepayers and shareholders based  
15 on the notion that PEP benefits both shareholders and ratepayers. But this could be said of any  
16 expense incurred by UNS Gas. The test is not who benefits, but rather whether the costs are  
17 prudent. Courts have made clear that such "sharing" theories based on mutual benefits are wholly  
18 illegitimate.<sup>79</sup> The Commission must allow recovery of the full amount of prudent costs.  
19 Moreover, the ROO is inconsistent with the recent APS rate order, which did not impose any  
20 restriction on the recovery of costs stemming from APS' similar cash-based incentive  
21 compensation program – which is the same type of cash-base compensation program as the PEP.

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23  
24  
25 <sup>78</sup> UNSG-13 at 9.

26 <sup>79</sup> See *Citizens Utility Board v. Illinois Commerce Comm'n*, 651 N.E.2d 1089, 1096-1100 (Illinois  
27 1995)(rejecting sharing of environmental clean-up costs); *Butler Township Water Co. v. Pennsylvania Public Utility Comm'n*, 473 A.2d 219, 221-22 (Pa. Cmwlth. 1984)(rejecting 50/50 sharing of rate case costs based on "shared benefits" theory).

1                               2.       *Supplemental Executive Retirement Plan ("SERP").*

2               Second, the ROO disallows 100% of UNS Gas' Supplemental Executive Retirement Plan  
3 ("SERP"). This decision is especially disconcerting because during the test year, UNS Gas had  
4 every reason to believe that SERP costs were recoverable. The most recent guidance available was  
5 the 2001 Southwest Gas rate order, which allowed full recovery of SERP costs.<sup>80</sup> Only after the  
6 test year the Commission change course and reject SERP costs in the 2006 Southwest Gas rate  
7 order. UNS Gas deserves to know what the rules are in advance, rather than having to guess at  
8 what principles the Commission will change in the future.

9               For example, if UNS Gas had known that SERP costs were not allowable, it could have  
10 increased base compensation instead. UNS Gas' overall employee compensation costs are prudent  
11 and that cash compensation is lower than comparable companies. Notwithstanding any evidence  
12 of imprudence, the ROO accuses UNS Gas of attempting to "disguise the costs" and playing "a  
13 veritable regulatory version of "Three-Card Monte".<sup>81</sup> This rhetoric is regrettable and should not  
14 be included in the final order issued by the Commission. There is nothing disguised about  
15 increased base compensation, which is apparent for all to see. And any party could attempt to  
16 show that the base compensation was imprudent.

17                               3.       *Officer's Long-Term Incentive Program.*

18               The third disputed component of employee compensation is the officer's long-term  
19 incentive program. UNS Gas noted the dispute about this program in its brief.<sup>82</sup> The ROO does  
20 not contain a ruling on this dispute but the overall expense level appears to exclude 50% of its  
21 cost. At the very least, UNS Gas is entitled to a ruling on this point. The substance of that ruling  
22 should be an affirmation of this program. Like the PEP, this program provides incentive  
23 compensation that helps make up for UNS Gas' below average base pay while also providing  
24 employees with an economic incentive to perform well.

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26 <sup>80</sup> *Southwest Gas Corp.*, Decision No. 64172 (October 30, 2001) at 14-15.

27 <sup>81</sup> ROO at 28:22-27.

<sup>82</sup> UNS Gas Initial Brief at 28.

1 The Commission should amend the ROO to allow UNS Gas full recovery of its \$137,262  
2 in expenses for its employee incentive compensation programs.

3 **D. UNS Gas is entitled to recover all of its requested "Small Expenses".**

4 The ROO proposes disallowing recovery of 50% of 1,995 small UNS Gas expenses – a  
5 disallowance totaling \$116,674. In so doing the ROO accepts RUCO's assertion that some these  
6 small expenses might be questionable,<sup>83</sup> theorizing that otherwise, ratepayers might suffer "the  
7 proverbial 'death by 1,000 cuts.'"<sup>84</sup> However, RUCO's witness, Mr. Moore, failed to detail any  
8 imprudence in the expenses and only provided a general explanation of why he questioned these  
9 1,995 expenses.<sup>85</sup>

10 UNS Gas' general manager, Mr. Gary Smith, testified that most of these expenses "are  
11 directly related to safety, system integrity and operator training."<sup>86</sup> Mr. Smith then explained the  
12 necessity of various categories of expenses on Mr. Moore's list. For example, Mr. Smith  
13 explained that most of the expenses related to travel for "regulatory-mandated functions such as  
14 leak surveys, safety audits, and training" and other expenses including "participation in the annual-  
15 mandated Commission pipeline safety audit and required operator qualification training, welder  
16 qualification training, and emergency response testing."<sup>87</sup> Many of the remaining expenses are for  
17 "small tools that are necessary for maintaining the pipeline system."<sup>88</sup> Mr. Moore's Surrebuttal  
18 Testimony did not contest Mr. Smith's explanation.

19 Thus, UNS Gas has provided a prima facie showing of the legitimacy of these expenses.  
20 The burden of proof therefore shifts to RUCO to show that they are imprudent. RUCO did not  
21 respond at all to the showing made by UNS Gas' general manager, and therefore failed to meet its  
22

23 <sup>83</sup> ROO at 24-25.

24 <sup>84</sup> ROO at 26:1-2.

25 <sup>85</sup> To limit disagreements, UNS Gas agreed to remove the few specific expenses Moore  
challenged.

26 <sup>86</sup> Ex. UNSG-16 at 5-6.

27 <sup>87</sup> Id.

<sup>88</sup> Id.

1 burden of proof. Moreover, it makes no sense to require 1,995 specific responses to a general  
2 objection. UNS Gas responded to RUCO's general objection with an explanation, which RUCO  
3 did not challenge further. That is all that is required, and these costs should be allowed in full.

4 The Commission should amend the ROO to allow recovery of the full amount of the  
5 \$233,347 in "small expenses".

6 **VIII. THE COMMISSION MUST USE FAIR VALUE TO SET RATES.**

7 In response to the Arizona Court of Appeals decision in Chaparral City Water Company,  
8 UNS Gas proposed to use the weighted average cost of capital as the rate of return for fair value  
9 rate base, but agreed that the rate increase in this case should be no greater than the increase  
10 proposed in its application. The ROO, however, adopted Staff's proposed methodology, which  
11 was the mathematical equivalent of the methodology struck down in Chaparral City. The  
12 Commission should not adopt a methodology that has been found to violate the Arizona  
13 Constitution.

14 **A. The Commission should abandon the discredited "backing-in" method.**

15 **1. *Staff used the unlawful backing-in method.***

16 The ROO follows Staff's approach regarding the use of the fair value rate base. Staff's  
17 approach is to "re-cast" its cost of capital as a "fair value cost of capital."<sup>89</sup> In other words, Staff  
18 "lowered the overall ROR applied to fair value rate base in order to achieve the same level of  
19 operating income calculated using Mr. Parcell's cost of capital and Staff's original cost rate  
20 base."<sup>90</sup> This approach is often called the "backing-in" method because the revenue requirement is  
21 determined using the cost of capital and the original cost rate base; the fair value numbers are the  
22 result of a meaningless, after-the-fact exercise.

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25  
26  
27 <sup>89</sup> Ex. S-37 at 9.

<sup>90</sup> Ex. UNSG-28 at 28.

1 Staff has clearly used this same discredited "backing-in" method here. The uncontraverted  
2 evidence is that Staff's approach in this case "is mathematically equivalent" to methods that are  
3 not permissible.<sup>91</sup> The Commission should reject this unlawful, discredited method.

4 **2. Staff's approach ignores fair value.**

5 Staff's witness, Mr. Parcell, candidly admitted that under his approach, fair value has no  
6 impact on rates. Under his approach, otherwise identical companies will have the same rates, even  
7 if their fair value rate base differs.<sup>92</sup> Parcell testified that, all other factors remaining equal, the  
8 following three hypothetical companies have the same return dollar requirement:<sup>93</sup>

9

Company	Original Cost Rate Base	Fair Value Rate Base	Return Dollar Requirement
10 1	\$10 million	\$ 10 million	Same for all three
11 2	\$10 million	\$ 20 million	Same for all three
12 3	\$10 million	\$100 million	Same for all three

13  
14

15 Under Staff's approach, fair value simply has no impact on rates.

16 **3. The Commission must use fair value.**

17 The Arizona Constitution contains a clear command: "The Corporation Commission  
18 shall... ascertain the fair value of the property within the State of every public service corporation  
19 doing business therein"<sup>94</sup> Fair value is not optional. As the Arizona Supreme Court recently held,  
20 the fair value section "is an imperative... [t]he constitutional provision in question does not... say  
21 or imply anything about the existence of discretion in the commission."<sup>95</sup> Not only is the  
22

23  
24 <sup>91</sup> Ex. UNSG-29 at 13.

25 <sup>92</sup> Tr. at 1027.

26 <sup>93</sup> Tr. at 1024-1027.

27 <sup>94</sup> Arizona Constitution, Article 15, § 14.

<sup>95</sup> *U.S. West Communications, Inc. v. Arizona Corp. Comm'n*, 201 Ariz. 242, 246, 34 P.3d 351, 355 (2001).

1 Commission required to find fair value, but it must also use that fair value finding in ratemaking.<sup>96</sup>  
2 Therefore, the Court of Appeals ruled that the Constitution requires “utilization of the fair-value  
3 finding” in setting rates.<sup>97</sup>

4 As shown above, under Staff’s approach, fair value has no impact on rates. Although Staff  
5 calculates a “fair value rate of return,” this calculation can be completed only after the revenue  
6 requirement is determined through the “backing-in” method. This after-the-fact calculation is  
7 simply a meaningless exercise. The constitutional requirement to use fair value cannot be satisfied  
8 when fair value is used merely as window dressing. Staff’s approach therefore must be rejected.

9 The ROO does not deny that it used the “backing-in” method. Nor does the ROO explain  
10 how its method amounts to using fair value, when the result will be the same regardless of the  
11 amount of fair value.

12 **B. Staff used the illegal “prudent investment” approach.**

13 The ROO completely follows Staff’s approach. Staff testified this approach follows the  
14 theory that investors should be allowed “a return on the capital they provided the utility” – or, in  
15 other words, a “return on their invested capital.”<sup>98</sup> Staff then argues that any difference between  
16 the original cost and the fair value should be disregarded or assigned a zero cost “because there are  
17 no investor-supplied funds supporting the difference between fair value rate base and original cost  
18 rate base.”<sup>99</sup> Staff’s focus on the value of invested capital is called the “prudent investment  
19 theory.”<sup>100</sup> Whatever the merits of this theory may be, under the Arizona Constitution, the  
20 Commission is forbidden to use it.<sup>101</sup> The ban on the use of the prudent investment theory has  
21

22 <sup>96</sup> *Simms v. Round Valley Light & Power Co.*, 80 Ariz. 145, 151, 294 P.2d 378, 382 (1956); *Scates*  
*v. Arizona Corp. Comm’n*, 118 Ariz. 531, 533-34, 578 P.2d 612, 614-15 (App. 1979).

23 <sup>97</sup> *Phelps Dodge Corp. v. Arizona Electric Power Co-op*, 207 Ariz. 95, ¶ 38, 83 P.3d 573, 586  
(App. 2004).

24 <sup>98</sup> Ex. S-37 at 8-9.

25 <sup>99</sup> Tr. at 1016.

26 <sup>100</sup> See *Simms*, 80 Ariz. at 151, 294 P.2d at 382.

27 <sup>101</sup> *Id.*; *Consolidated Water Utilities, Ltd. v. Arizona Corp. Comm’n*, 178 Ariz. 478, 141, 875 P.2d  
137, 482 (App. 1994); *City of Tucson v. Citizens Utilities Water Co.*, 17 Ariz. App. 477, 482, 498  
P.2d 551, 556 (1972).

1 been made very clear by the Arizona Supreme Court: “[the] Commission cannot be guided by the  
2 prudent investment theory.... The amount invested is immaterial.”<sup>102</sup> As the court explained,  
3 “under the law of fair value a utility is not entitled to a fair return on its investment; it is entitled to  
4 a fair return on the fair value of its properties devoted to the public use, no more and no less.”<sup>103</sup>

5 **C. The ROO’s procedural argument should be rejected.**

6 The ROO asserts that UNS Gas’ fair value argument must be rejected because it was only  
7 raised in rebuttal testimony. The ROO states that if UNS Gas wished to present this argument it  
8 should have withdrawn its application and started over again. That approach would result in a  
9 delay of at least a year, while UNS Gas is already under-earning and subject to significant financial  
10 stress. Moreover, the event that triggered this issue did not happen until shortly before the rebuttal  
11 testimony was filed.

12 More fundamentally, the ROO’s claim that this argument is procedurally barred is  
13 inconsistent with the treatment of arguments offered by other parties in this case. For example,  
14 Staff did not challenge rate case expense in its Direct Testimony, but it was allowed to pursue that  
15 issue in its Surrebuttal Testimony and was permitted to introduce an entirely new justification for  
16 its position on the stand. If entirely new testimony is permitted during the hearing on significant  
17 issues like rate case expense, then UNS Gas’ approach of raising the fair value issue in rebuttal  
18 testimony prior to the hearing is appropriate.

19 **D. UNS Gas’ method is the only permissible method proposed in this case.**

20 All parties, including UNS Gas, have struggled with how to address the renewed emphasis  
21 on fair value. Because this issue arose after the application was filed, UNS Gas has agreed that the  
22 rate increase in this case should be no greater than the increase proposed in its application. UNS  
23 Gas addressed the fair value issue by proposing to use the weighted average cost of capital as the  
24  
25

26  
27 <sup>102</sup> *Arizona Corp. Comm’n v. Arizona Water Co.*, 85 Ariz. 198, 203, 335 P.2d 412, 415 (1959).

<sup>103</sup> *Id.*

1 rate of return for fair value rate base.<sup>104</sup> This is not the only possible approach. It is, however, the  
2 only approach presented in this case that complies with the Arizona Constitution.

3 The ROO sets up a straw man, stating that UNS Gas argues that this method must be  
4 used.<sup>105</sup> The ROO then accuses UNS Gas of being “disingenuous” because the courts have stated  
5 that this method is permissible but not required.<sup>106</sup> But UNS Gas never said that this method must  
6 be used, and it explicitly stated that there were other permissible methods.<sup>107</sup> The problem in this  
7 case is that neither Staff nor RUCO proposed any of the other permissible methods. Instead, Staff  
8 and RUCO proposed the one method that is known to be impermissible. Whatever the  
9 Commission does, it must not use that method. UNS Gas has presented a permissible option. The  
10 Commission can choose that option, or it can devise a different permissible option. But the  
11 Commission should reject the ROO’s decision to use a clearly illegal method.

12 The Commission should amend the ROO to adopt UNS Gas’s proposal on Fair Value.

## 13 **IX. TECHNICAL ISSUES ARISING FROM THE ROO.**

### 14 **A. CARES deferral issue.**

15 UNS Gas proposed continuing the deferral of costs relating to the CARES program. Staff  
16 suggested that there be no further deferrals in the future. The ROO adopts this Staff  
17 recommendation, and UNS Gas will not challenge that decision. However, under the present  
18 system, UNS Gas accumulated a deferred balance of \$400,000. Staff, and thus the ROO, did not  
19 present a plan for addressing the deferred balance. The deferred balance was accumulated in  
20 accordance with existing Commission orders, so something must be done to address this balance.  
21 UNS Gas therefore requests that the Commission provide some direction regarding how this  
22 deferred balance will be treated. UNS Gas proposes that the Commission allow recovery of these  
23  
24

25 <sup>104</sup> Ex. UNSG-28 at 28; Ex. UNSG-29 at 12-13.

26 <sup>105</sup> ROO at 49:15-18.

27 <sup>106</sup> ROO at 50:3.

<sup>107</sup> UNS Gas Initial Brief at 42-43.

1 deferred expenses by amortizing the deferred balance over the same amortization period as rate  
2 case expense (i.e. three years, on the assumption that rates will be in effect for that long).

3 **B. Working Capital and other flow through adjustments.**

4 Determining the appropriate level of working capital is dependent, in part, on decisions on  
5 other revenue requirement issues. The ROO did not recalculate working capital to reflect all of the  
6 decisions on other issues proposed in the ROO. Attached as Attachment 2 is a schedule showing  
7 the necessary adjustment. UNS Gas requests that the Commission use the correct level of working  
8 capital.

9 There are a number of other "flow-though" items determined by other revenue requirement  
10 decisions. The ROO does not properly adjust some of these items to reflect all of the decisions it  
11 proposes on various issues. For example, income tax expense was not recalculated to reflect the  
12 final revenue level. Likewise, the ROO did not properly synchronize interest expense to match  
13 the proposed rate base and weighted average cost of capital. These additional adjustments are also  
14 shown on Attachment 2.

15 The proper methods for calculating these items are well-understood, and UNS Gas does not  
16 anticipate that the rate experts for other parties will dispute the accuracy of these modifications.  
17 Overall, these technical calculation errors understate the overall revenue requirement by \$279,155.  
18 The ROO should be revised to reflect the proper calculation of these items. However, to the extent  
19 that the Commission modifies the ROO in other respects, these flow-through items will have to be  
20 recalculated to reflect the Commission's decision on those other matters.

21 **X. CONCLUSION.**

22 The Commission should take action to support UNS Gas' financial integrity in the face of  
23 an onslaught of growth so that much needed capital can be raised on reasonable terms. The  
24 Commission also should reduce the cross-subsidy that cold weather customers would be forced to  
25 pay under the rates proposed by the ROO. Further, the Commission should ensure that its order  
26 complies with applicable legal standards, including the United States Constitution and the Arizona  
27 Constitution.

1 Proposed language for amendments relating to each specific argument are included in  
2 Attachment 3 as follows:

Amendment	Issue
1.	CWIP
2.	Post Test Year Advances
3.	Deduction of Advances
4.	GIS
5.	Return on Equity
6.	Monthly Charge
7.	Rate Case Expense
8.	PEP
9.	SERP
10.	Officer's Incentive Compensation
11.	Small Expenses
12.	Fair Value
13.	CARES Deferral
14.	Technical Corrections

1  
2 RESPECTFULLY SUBMITTED this 24th day of October, 2007.

3 UNS Gas, Inc.

4  
5  
6 By



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14  
15 Original and 17 copies of the foregoing  
filed this 24<sup>th</sup> day of October, 2007, with:

16 Docket Control  
17 Arizona Corporation Commission  
1200 West Washington Street  
18 Phoenix, Arizona 85007

19 Copy of the foregoing hand-delivered  
this 24<sup>th</sup> day of October, 2007, to:

20 Chairman Mike Gleason  
21 Arizona Corporation Commission  
1200 West Washington Street  
22 Phoenix, Arizona 85007

23 Commissioner William A. Mundell  
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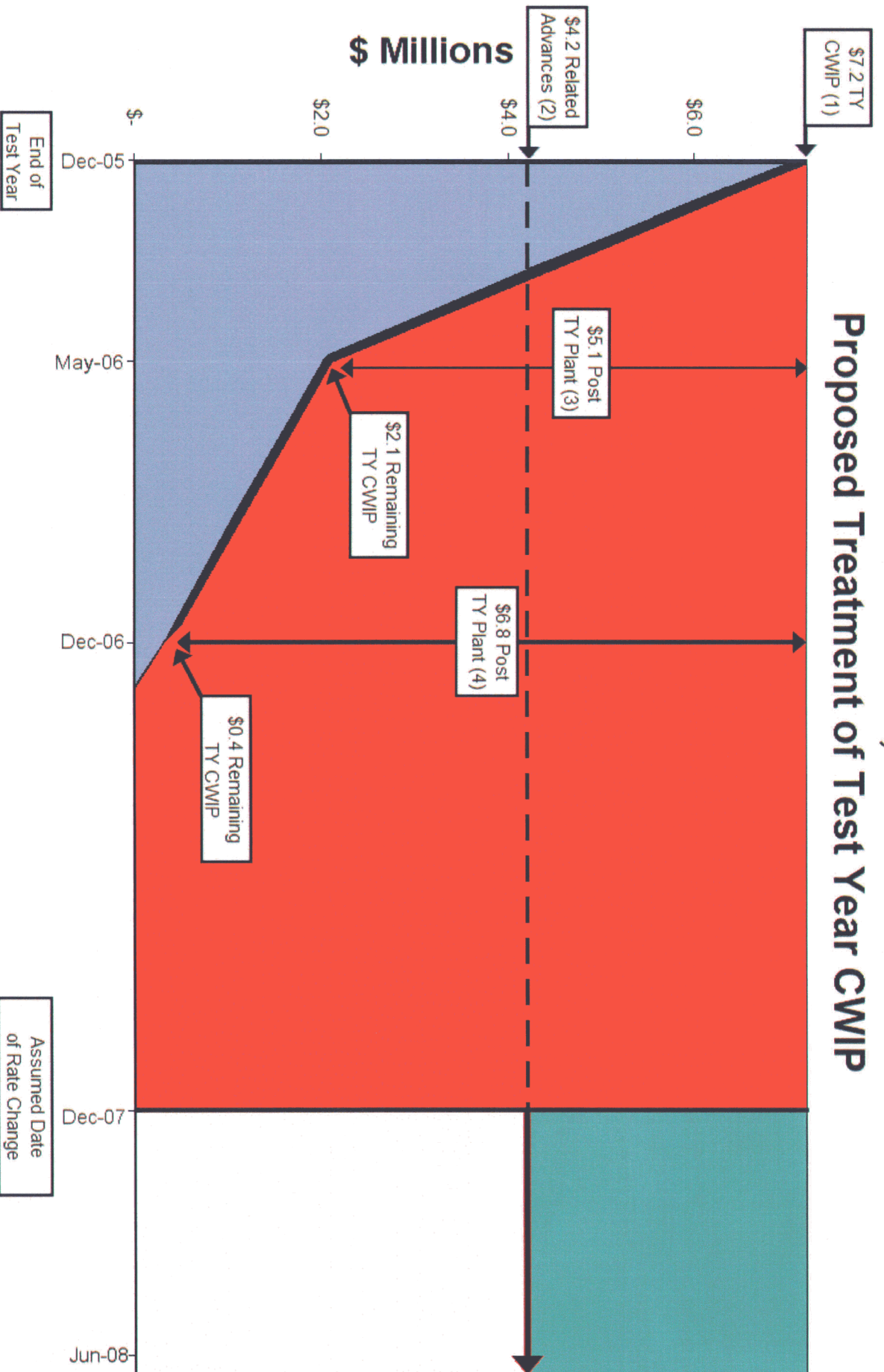
23  
24 By   
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27

# ATTACHMENT

"1"

# UNS Gas, Inc.

## Proposed Treatment of Test Year CWIP



	Test Year CWIP Accruing AFUDC
	Test Year CWIP Closed to Plant in Service (No AFUDC & Not in Rate Base)
	Test Year Balance of CWIP in Rate Base (Net of Related Customer Advances)

### References

- (1) Grant Direct, p. 27 line 16.
- (2) Grant Rebuttal, p. 15, line 27.
- (3) Grant Direct, p. 28, line 25.
- (4) Grant Rebuttal, p. 16, line 10.

# ATTACHMENT

"2"

[illegible]

UNSGAS, INC.							Exhibit Page 2 of 4
COMPARISON OF ADJUSTMENTS TO REVENUE REQUIREMENT							
TEST YEAR ENDED DECEMBER 31, 2005							
	Surrebuttal 4/4/07	ROO As Issued 10/15/07	ROO Corrections 10/15/07	Difference	Description of Correction Adjustment	UNSG Witness	
Original Operating Income - Unadjusted	ACC Staff \$10,590,155	\$10,590,155	\$10,590,155	\$0		Kissinger	
<b>Operating Income Adjustments</b>							
<b>Operating Revenue Adjustments</b>							
Griffith Plant Operations	(865,152)	(865,152)	(865,152)	-		Dukes	
Purchased Gas Cost & Gas Cost Revenue	(75,545,465)	(75,545,465)	(75,545,465)	-		Dukes	
Customer Annualization (Staff Adjustment C-1, RUCO Operating Income Adjustment No. 14)	828,115	828,115	828,115	-		Erdwurm	
Weather Normalization (Staff Adjustment C-2, RUCO Operating Income Adjustment No. 15)	518,883	518,883	518,883	-		Erdwurm	
NSP Revenue & Gas Cost	(15,738,093)	(15,738,093)	(15,738,093)	-		Dukes	
CARES	(203,181)	(203,181)	(203,181)	-		Dukes	
Total Adjustments to Operating Revenues	(91,004,893)	(91,004,893)	(91,004,893)	-			
<b>Operating Expense Adjustments</b>							
Griffith Plant Operations	(164,614)	(164,614)	(164,614)	-		Dukes	
Purchased Gas Cost & Gas Cost Revenue	(75,545,465)	(75,545,465)	(75,545,465)	-		Dukes	
NSP Revenue & Gas Cost	(15,269,790)	(15,269,790)	(15,269,790)	-		Dukes	
Payroll Expense (Staff Adjustment C-8 & C-9)	317,540	369,928	369,928	-		Dukes	
Payroll Tax Expense (Staff Adjustment C-10)	16,559	16,559	16,559	-		Dukes	
Pension & Benefits (RUCO Operating Income Adjustment No. 11)	54,594	54,594	54,594	-		Dukes	
Post Retirement Medical	57,676	57,676	57,676	-		Dukes	
Worker's Compensation (Staff Adjustment C-13, RUCO Operating Income Adjustment No. 1)	-	-	-	-		Dukes	
Incentive Compensation (Staff Adjustment C-6, RUCO Operating Income Adjustment No. 2)	(130,163)	(130,163)	(130,163)	-		Dukes	
Rate Case Expense (RUCO Operating Income Adjustment No. 8; Staff Adjustment No. C-19)	85,000	100,000	100,000	-		Dukes	
Bad Debt Expense (Staff Adjustment C-3, RUCO Operating Income Adjustment No. 17)	319,021	317,758	317,758	-		Dukes	
Interest On Customer Deposits	16,507	16,507	16,507	-			

[illegible]

UNSGAS, INC.									
COMPARISON OF ADJUSTMENTS TO REVENUE REQUIREMENT									
TEST YEAR ENDED DECEMBER 31, 2005									
	Surrebuttal 4/4/07	ROO As Issued 10/15/07	ROO Corrections 10/15/07	Difference	Description of Correction Adjustment	UNSG Witness			Exhibit Page 4 of 4
<b>Operating Expense Adjustments (cont'd)</b>									
Unnecessary Expenses (RUCO Operating Income Adjustment No. 6)	-	(116,674)	(116,674)	-		Smith/Dukes			
Nonrecurring Expenses (RUCO Operating Income Adjustment No. 10)	-	(2,584)	(2,584)	-		Smith			
Property Taxes (Staff Adjustment C-12, RUCO Operating Income Adjustment No. 7)	1,511,080	1,511,080	1,511,080	-		Kissinger			
Income Taxes (Staff Adjustment "All C's", RUCO Operating Income Adjustment No. 22)	(394,329)	(411,896)	(251,325)	160,571	Calculated based on adopted adjustments and proper synchronization of interest to reflect the capital structure proposed in the ROO	Kissinger			
RUCO Operating Income Adjustment No. 20	-					Dukes			
Total Adjustments to Operating Expense	(90,315,119)	(90,166,226)	(90,005,655)	160,571					
Total Net Adjustments	(689,774)	(838,667)	(999,238)	(160,571)					
Adjusted Operating Income	\$9,900,381	\$9,751,488	\$9,590,917	(\$160,571)					
Operating Income Deficiency	\$2,648,858	\$3,075,936	\$3,246,467	\$170,532					
Gross Revenue Conversion Factor	1.636969	1.6370	1.6370	1.6370		Kissinger			
Increase in Gross Revenue Requirement	\$4,336,098	\$5,035,210	\$5,314,365	\$279,155	Additional increase necessary to reflect the proper cash working capital and income tax levels.				

ATTACHMENT

"3"

**ATTACHMENT 3**

**UNS GAS'**

**SUGGESTED AMENDMENTS  
TO  
RECOMMENDED OPINION AND ORDER**

## **Amendment 1**

### **CWIP**

- (1) Page 6, line 26 to Page 7, line 15 DELETE entire text
- (2) Page 6, line 26 INSERT the following: Staff and RUCO make cogent arguments regarding why CWIP should not be allowed for many utilities. But in this case there is significant evidence that growth is causing substantial negative financial impacts to UNS Gas. In the long run, both ratepayers and shareholders benefit from financially healthy utilities. Accordingly, in this case, we will allow CWIP as a means of addressing the financial stress caused by growth and to put UNS Gas' financial condition on a firm footing. Furthermore, in light of the short-term nature of the construction projects included in the test year balance of CWIP, it is appropriate for UNS Gas to continue accruing AFUDC on all eligible construction projects with no offset required for the balance of CWIP included in rate base.
- (3) MAKE ALL CONFORMING CHANGES

## **Amendment 2**

### **Post Test Year Plant**

- (1) Page 8, lines 1 through 16 DELETE entire text
- (2) Page 8, line 1 INSERT the following: Staff's concerns are valid in a generic sense. However, the evidence in this case shows that revenues from new customers do not come close to covering the costs associated with new plant to serve those customers. (Ex. A-28 at 10 and Attachment KCG-10) We have allowed post test year plant in many previous cases. UNS Gas' extraordinary growth and financial stress make it a good candidate for post test year plant, and we will accordingly grant UNS Gas' request to include post test year plant in rate base.
- (3) MAKE ALL CONFORMING CHANGES

### **Amendment 3**

#### **Deduction of Advances related to CWIP**

- (1) Page 9, line 16 to Page 10, line 2 DELETE entire text
- (2) Page 9, line 16 INSERT the following: As UNG Gas notes, the purpose of deducting advances is to ensure that the advance has no net impact on rate base. We would not permit advances to result in an increase to rate base, and by the same token, we agree that they should not result in a net reduction to rate base. We recently recognized in similar circumstances that deductions in such situations would cause rate base to fall rapidly, only to quickly bounce back as the related plant is placed in service. *Arizona-American Water Co.*, Decision No. 69914 (September 27, 2007) at 7. For the same reasons, we agree with UNS Gas and will not deduct advances that relate to test-year CWIP that is not yet in rate base.
- (3) MAKE ALL CONFORMING CHANGES

## **Amendment 4**

### **Geographic Information System (GIS)**

- (1) Page 10, line 24 to Page 11 line 8 DELETE entire text
- (2) Page 10, line 24 INSERT the following: UNS Gas counters that rates should be based on the economic reality of costs, not bookkeeping mistakes. There is no dispute about the actual amount of the GIS costs. Because the GIS costs were mandated by this Commission and clearly result in increased safety and efficiency, we will recognize a regulatory asset for the GIS costs, to be amortized as proposed by UNS Gas.
- (3) MAKE ALL CONFORMING CHANGES

## **Amendment 5**

### **Return on Equity**

- (1) Page 44, line 16 to Page 45, line 11 DELETE entire text
- (2) Page 44, line 16 INSERT the following: In the recent APS case, we weighed the competing arguments and approved an ROE that was significantly higher than the cost of equity recommended by the Staff in that case, which was based on the same witness and methods used in this case. In this case, we will follow a similar approach. UNS Gas has provided compelling evidence in support of a higher cost of equity relative to larger publicly-traded utilities, the vast majority of which pay common dividends and enjoy a much more moderate rate of growth in required plant investment. Accordingly, we will approve an ROE of 11%, which is only slightly higher than what was recently granted to APS.
- (3) Page 45, line 8 INSERT revised chart reflecting option chosen
- (4) MAKE ALL CONFORMING CHANGES

## **Amendment 6**

### **Monthly Charge**

- (1) Page 56, line 2 to Page 57, line 9 DELETE
- (2) Page 56, line 2 INSERT the following: RUCO, Staff and UNS Gas agree that the monthly charge should be revised to move closer to reflecting fixed costs. Moreover, we are concerned with the extent of the subsidy cold weather customers are providing to warm weather customers. We find that the monthly charge should be increased to better reflect fixed costs and to reduce the subsidy paid by cold weather customers. Accordingly we will adopt a monthly charge of \$17.
- (3) MAKE ALL CONFORMING CHANGES

## **Amendment 7**

### **Rate Case Expense**

- (1) Page 22, line 6 to Page 22, line 18 DELETE entire text
- (2) Page 22, line 6 INSERT the following: UNS Gas lacks the in-house rate and legal departments Southwest Gas relies on. Moreover, UNS Gas had to respond to twice as many data requests as Southwest Gas. We therefore agree with UNS Gas that its rate case expense cannot be directly compared to that of Southwest Gas. No party has suggested that UNS Gas has pursued frivolous issues or that their experts or lawyers cost more than normal. Accordingly, we will approve UNS Gas' proposed rate case expense.
- (3) MAKE ALL CONFORMING CHANGES

## **Amendment 8**

### **PEP**

- (1) Page 27, line 1 to Page 27, line 18 DELETE entire text
- (2) Page 27, line 1 INSERT the following: As long as a utility's overall employee compensation costs are reasonable, we will allow recovery of the costs of the underlying compensation programs. As UNS Gas notes, incentive compensation is standard, both in the utility industry and in business corporations in general. Accordingly, we will allow recovery of UNS Gas' PEP costs.
- (3) MAKE ALL CONFORMING CHANGES

## **Amendment 9**

### **SERP**

- (1) Page 27, line 27 DELETE "In that case,"
- (2) Page 27, line 28 to Page 29, line 3 DELETE entire text
- (3) Page 27, line 28 INSERT the following: While we disallowed SERP costs in the most recent Southwest Gas rate case, we allowed them in the previous Southwest Gas rate case. As long as a utility's overall employee compensation costs are reasonable, we will allow recovery of the costs of the underlying compensation programs. Accordingly, we will allow recovery of UNS Gas' SERP costs.
- (4) MAKE ALL CONFORMING CHANGES

## **Amendment 10**

### **Officer's Incentive Compensation Program**

- (1) Page 29, line 3 INSERT new section as follows:

#### Officer's Incentive Compensation Program

Consistent with our treatment of the PEP, will not disallow UNS Gas' costs for its Officer's Incentive Compensation Program.

- (2) MAKE ALL CONFORMING CHANGES

## **Amendment 11**

### **Small Expenses**

- (1) Page 25, line 5 to Page 26 line 2 DELETE entire text
- (2) Page 25, line 5 INSERT the following: We do not believe that it is reasonable to require a specific explanation for each of the 1,995 minor expenses challenged by RUCO, when RUCO only makes a general objection covering all of these numerous, disparate small expenses. RUCO did not rebut the explanation of these expenses by Mr. Gary Smith for UNS Gas. Accordingly, we will not disallow these costs.
- (3) MAKE ALL CONFORMING CHANGES

## **Amendment 12**

### **Fair Value**

- (1) Page 48, line 24 to Page 51 line 4 DELETE entire text
- (2) Page 48, line 24 INSERT the following: We acknowledge that we must use fair value in setting rates. Staff's witness, Mr. Parcell, stated that using his approach, rates would remain the same no matter what fair value we find. (Tr. at 1024 to 1027). We do not see how that approach properly reflects fair value. Reluctantly, we will approve UNS Gas' proposal to apply the weighted average cost of capital to the fair value rate base. We will also hold UNS Gas to its commitment that the rates approved herein may not exceed the amount requested in its original rate application.
- (3) MAKE ALL CONFORMING CHANGES

## **Amendment 13**

### **CARES deferred balance**

- (1) Page 66, line 23 INSERT new paragraph, as follows:

Staff also recommends discontinuing further deferrals of CARES costs. We agree. UNG Gas has a deferred balance of \$400,000 relating to CARES costs already incurred. We will allow this deferred balance to be recovered over three years.

- (2) Make all conforming changes.

## **Amendment 14**

### **Technical Corrections**

- (1) We direct that the final decision in this matter reflect the correction of all the calculation errors shown on Attachment 2 to UNS Gas' exceptions.

**MAKE ALL CONFORMING CHANGES**